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ADP - Automatic Data Processing Inc at Nasdaq Investor Program

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PRESENTATION

James Faucette - *Morgan Stanley - Analyst*

Okay, we are going to go ahead and get started here, try to stay right on time as we do. I am James Faucette from Morgan Stanley; I cover com equipment, so many of you have seen me for that. But I also cover the payments area and some of the financial services area for Morgan Stanley out of the US.

And we are very pleased today to have ADP, Automatic Data Processing, Jan Siegmund, CFO, is here with us today to kind of go through a fireside chat or a list of prepared questions that I have. Obviously as we go through we will open it up to the audience. So if there are any audience questions, happy to entertain those as well.

But, Jan, maybe I will just kind of kickoff and just ask you -- you guys have been working really hard at transitioning from being a payroll Company to, as you characterize it, a human capital management Company. And at your 2015 Investor Day you talked about a global opportunity of roughly $110 billion. You have about 10% of that market. What is the plan to take more share and where does that share come from?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes, so, one of the beautiful things for ADP that we enjoy is that we are positioned in a nice growth market, James, as you said, the markets are large. We think it is $110 billion plus has been -- and is growing twice the rate of GDP. So it is an attractive growth market that we are operating. And we have been able to outgrow that market and slowly gaining share.

If you look across the board, we offer a few statistics relative to how we believe we are outcompeting the market. Number one, our client count has been growing 4% to 5% on average every year. And as you know, Company formation is probably at a rate of 2%. So we have been gaining share count by number of companies. That is important to us because obviously companies make buying decisions and we want to be on the winning side of that outcome.

So that has been a source of driving market share growth. And the second very important source is we have been gaining shares in markets that are beyond payroll. So we have been leveraging our strong client base in payroll with more than 600,000 clients across the globe and have been transforming them into buying a fuller bundle.

And that strategy has been working for a number of years for us now and has made us not only the number one player globally on payroll, but also the number one player on plans for benefit administration. The Affordable Care Act has helped us there so we have now the largest number of benefit plan under administration globally.

We are number one provider by number of clients relative to time and labor management, workforce management solutions, and so forth. You can see in our 401(k) business we have a -- we cross sell all this stuff into our client base and that has been driving growth.

And lastly, we -- as ADP is technology based our largest amount of our clients use the latest -- our latest platforms, our cloud-based SaaS solutions. But we offer really more than a typical software solution would offer. We offer compliance, we offer incremental services and we offer HR BPO services on top of our own platforms. And so the strong growth of our HR BPO solutions has also helped to fuel the revenue growth of ADP.

So in summary, we are aiming and are succeeding in driving client count growth, so core client share. We are driving deeper product penetrations of our HCM bundle and have achieved good success historically; we are planning to continue that. And lastly, our HR BPO solutions have very strong demand, actually growing very nicely.

And we have a very long growth rate because only a very small percent of our clients will use really a fully outsourced HR BPO solution. So those are the three most important drivers for market share gains.

QUESTIONS AND ANSWERS

James Faucette - *Morgan Stanley - Analyst*

So when you look at your business composition, you are about 20% international today. You talked about pursuing international and global opportunities. Where do you think we should expect that you will get to maybe even 10, 15 years from now? What do you want it to look like?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

So today about 20% of our revenues come from international markets and the fastest component of our international business is our strength in our multinational solutions. So we have a business that allows us to serve clients of all sizes really with integrated multinational solutions that have at the core payroll, but really also include HR and talent and time and attendance solutions.

That multinational business has been growing at a very good clip and more in line of our PEOs and the 15 plus percentage growth number and has been fueling our international growth. I see a continuation of strong demand for our multinational solutions, very differentiated, we have very high market share in it and for many a very unique offering.

That has made us partner with many players in the market who integrate with us. So the multinational global capability is really a core strength. It is fueled by our strength of having presence in 40 countries with our own solutions. So we have local best-of-breed solutions as we call them in 40 countries, historically strength in Europe but really across the globe, Asia Pac, India, China, you name it, Australia, Latin America.

And those strong market positions in those countries have helped us to create the multinational offer, but also some of those solutions have grown nicely. So, Asia Pac obviously a strategic importance for us, small but growing fast.

So the goal would be I think leveraging the strength of multinational to drive good growth and then make consistent progress on our best-of-breed countries which have been in the last few years growing.

But our European countries, I don't think I share secrets, have been not contributing to growth acceleration at ADP. They have been kind of going along as the European economy has been slow. And so as that picks up hopefully at some point we hope to benefit from that going forward.

James Faucette - *Morgan Stanley - Analyst*

So turning to competition. We were talking beforehand about questions you get from investors around competition. And it seems like the investment community, we tend to focus on specific competitors. So whether it be like Intuit or where Paychex is or you have Paylocity and Paycom, etc. Can you help us contextualize maybe where that group of competitors or who you run into individually, but then also more broadly what the competitive environment really looks like?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

So I think that is the question we get the most from you investors is how is ADP successful at competing. And so I start maybe by describing ADP as a very comprehensive vendor faces a multitude of competitors. And so we're offering product solutions in the small space from a one-person payroll provider to -- we offer payroll and HR services, actually the largest companies of the US or on the globe are our clients.

So it is very comprehensive relative to the market segment we serve, it is very comprehensive relative to the product sets that we serve. So -- and it is very hard to nail down single competitors that have a material impact onto ADP's growth trajectory.

Our strategic challenge that we have to address is how do we stay focused to compete against many competitors, not just one. And for many of our competitors we are the natural target because we have by far the largest market share, we are by far the largest in the space, it is very easy to focus on us. And we as a management team have to compete against many smaller competitors who are very focused on seeing us as a target.

And so, if I describe that situation maybe also from an angle of losses. So we have retention of around a little bit better than 90%. And so we still lose 10% of our recurring revenue. If you are a $12 billion that is a lot of revenues you lose every year. And when we look at the sources of where that goes, to which competitors, you see that none of these competitors have really a very large share in those losses that we experience. And so we lose to many.

And that is good because I think we are not threatened by a single competitor at all really, and it makes it just harder to keep us focused on each of them to outcompete. And so, in the net what we do is obviously we look at our distribution results. We have had great success in distributing our solutions and, aside from some retention impact, we also had -- we still have very good retention rates. So it has allowed us basically to go back to these market share gains very steadily to expand that.

So to specific competitors I think, again not really going into single companies here, the principal competition comes from different sources. You have software vendors that are competing now with cloud-based solutions but in a classic software value proposition argument against ADP's more comprehensive technology plus service plus compliance argument of gaining clients.

And so, when you compete in those markets you should think about these markets as segmented. They are clients who have a stronger technology focus and are more convinced that a software solution will be the answer to them. And that has been the case for a long time, even prior to the cloud. And that would make the argument, well technology solves this and a lot of your employees and your managers will get great self-service and the software will do it. That is the classic software argument.

And then I think our argument is you live in an ever more complex world where you want to focus on your core business and we help you really to work through all your compliance and regulatory effect. We take care of your transactions and increase that your employees have. And so we offer a better outcome, that is our pitch basically. And so, the segments have been fairly stable. If anything I think the outsourcing argument, if you will, has been gaining a little bit of share, but very gradual.

And the last comment on competition I want to make is -- that I observe from our perspective is it is very easy to have certain observation biases because the competition is what is a public company. When you look at it that is where information is. And that is generally a very narrow view. There tends to be a little bit more up market focus and tends to be narrow because the competition is broad.

So on the software vendors we at times compete of course against ERP systems. We at times compete in the down market against accountants, for example, and non-technology vendors. So it is really a very broad range of -- which makes it a little harder to understand and nail down of how you actually win because it is not a market of a few but it is a market of many competitors.

James Faucette - *Morgan Stanley - Analyst*

So if I can ask, just to break apart the retention question. I think you -- like your share gains and your continued growth speak to your ability to have positive gains on an annual basis. But in the retention area how much of your retention or your losses are attributable to not competitive losses but companies going out of business or being acquired or that kind of thing? How big of a factor is that?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes, let's talk a little bit about retention because I don't want to just give the big sales pitch here, but just talk also about our opportunities that we have as a Company.

So number one, the losses -- when we look at where these clients go, I think I mentioned it, there is a very diverse set of clients -- competitors that take these clients. And the best way to look at it is of course a balance of trade is are we gaining from these competitors and losing against these competitors? And then we feel good about most situations. Not about all; we have certain opportunities where we can do better, number one.

Number two, the mix of losses that are due to out of business is [empirically] important in our down market. Down market is the most important loss reason; companies go out of business, declare bankruptcy or stop processing or existing just on a more frequent basis. And the US economy has been very good. So we have seen the bankruptcy number and all that stuff improving and that is definitely a cyclical number.

So we have excellent retention in our small business segment and partially that has been aided in particular in the early years of the recovery by an improvement of the out of business rate. Now if the economy were to get turning bad that would certainly reverse, we would have no impact on it.

On the other hand, at the up market, to give you a [crass] example, the largest reason why we lose client is what we call covert action and merger. So it is a client gets acquired or sells a division and so we are very successful in gaining them also in those situations but that is also the most important reason.

And the second most important reason is that they revert to ERP. And I am giving this kind of a hands on explanation. And that risk is particularly high if we are only a payroll provider to that client. And then it is a little easier to say, hey, I make a big ERP decision and payroll needs to come into the ERP.

So our strategy to become a more comprehensive HCM provider is partially -- or addresses that because we have become a more important partner to large clients as well and that is basically our competitive argument to not face it. Our up-market retention is in the mid-90s, so we still have excellent retention. Of course up-market even higher in certain products. But that becomes the most important reason.

James Faucette - *Morgan Stanley - Analyst*

So, I want to dovetail a little bit with your comments around losses from time to time to ERP and bringing that back in house. On the flipside, you have relationships with a lot of the big ERP vendors like SAP Oracle, Workday, etc. How do your economics work in those relationships? And I mean it seems like there is a little bit of co-op-petition, if you would, in a lot of these accounts potentially. So how is that resolved?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

We're talking now about the very large multinational and large national account market in the US. And this market always had a co-op-petition element to it. So we have done this for a very many years, partnered with our ERP vendors. And because the up-market is generally I think we would still see it not a suite buyer to the degree that it may look to the outside. So large companies still looking for best-of-breed solutions and rarely exchange the entire suite of HCM products.

It is like it is just not very realistic if you think you have your time and attendance system built in, you have your benefit administration system, you have pension plans, you have HR, you have performance management. It is not that Fortune 500 -- or Fortune 100 company would say now I am going to throw this all out. They are going to be replacing certain elements that they feel are most valuable.

And so when these deals happen and we partner with ERP vendors, the strength is our multinational capabilities because largely the ERP vendors cannot offer that solution and we have a solution. And so that is a very natural partnership for us to do so and it is under compliance elements. I think it would be -- we have very strong tax filing money movement compliance solutions in the up-market that would be silly for a Fortune 100 company not to choose ADP.

So we participate in it and the beauty is actually that our services tend to be transaction rich or revenue richer. So we feel we have a very good share as we participate in that. We don't quite achieve then to be the integrated complete vendor, but you can't have everything in life.

So we have a -- I think we have a fair shot at it. And I am a believer and I think our management team believes in it and executes in at that in today's world you have to live in co-op-petition. And we are happy and we are proud that we achieve these partnerships with the ERP vendors that are very fruitful for us.

James Faucette - *Morgan Stanley - Analyst*

So turning to a different topic. We've been getting a lot of questions, I am sure you have as well, since the US election. What that means for the Affordable Care Act and for companies that might be affected generally. But specifically for you and ADP, can you walk us through what the likely outcome will be as well as kind of what a worst case scenario might look like if we were to repeal or change of the Affordable Care Act?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes. So clearly the election had many impacts onto ADP but it also it is at the very early stage with (inaudible) I think everybody involved including the president-elect and his team are kind of developing their views and ideas about how to proceed. And a few things seem to be emerging that could be impacting ADP.

But I really have to be prefacing this whole thing, there is a very high degree of uncertainty around it. So it is really -- I can't really [judgment] -- but I want to give you a little bit the thought process that we are going at the Company through and start with the elements that could prove risk or opportunity. But largely I think you would think of are they going to be in danger.

So the Affordable Care Act, clearly there is a desire in particular in Congress I would say in the US to repeal that Act. That is not going to be so easy to do and I think the president-elect has made clear that he does not want to just repeal the Act, he wants to replace it with something better.

And so, I think the majority in the House and in the Senate as now working on ideas of how to improve the Affordable -- replace it with something. And that is -- we don't know what that is. I have to say (inaudible) they may not know it exactly either at this point in time.

James Faucette - *Morgan Stanley - Analyst*

So they are coming up with the ideas right now?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Right. And there are -- there have been proposals, the Speaker of the House has made proposals historically. So when you analyze all this there will be changes coming to and from. If you take the optimistic view you would say that is going to change the requirements and that will be a good thing for us because we are going to keep our clients compliant and so forth.

Certainly other elements may get repealed and the worst case would be that they have got to get rid of it, which has never happened in the US history. But a lot of stuff, fun stuff has happened in the last three weeks in the US. So 20 million people have healthcare because of the Affordable Care Act and many have been voters for the president-elect. So that is a judgment.

But the revenue that we generating out of the Affordable Care Act, we all but disclosed the revenue and is we -- it is basically around a couple hundred million dollars. And so that is basically -- I don't think it is going to be at risk, but that is going to be a potential impact that we could face. It is not going to be destroying our Company, certainly not a pleasant moment to not have Affordable Care Act revenue to us.

But I think the more likely outcome is modifications to the thing. And what we do to a large degree in our product is we are fulfilling reporting requirements like it's called in the US a 1095 and 1094 forms and you have to collect a lot of information to be compliant with it. And my personal assessment is I think any solution will like to have these type of reporting capabilities because they ensure that fraudulent activity is being caught. They have controlling elements to it.

If you get tax credits, which I think is one of the elements that the Republican solution may be favoring. There will be a need to have this type of reporting things to avoid fraud. And so the reporting requirements a lot of people think will stay no matter what. So again, I give you too many thoughts here for what is a very uncertain situation.

Let's move on to other elements that impact ADP. Generally I think there is a belief in the markets that increased infrastructure spending and tax reform and focus on reducing regulatory complexity will boost economic activity. A good economy is good for ADP and in particular if you compare that with an anti-immigration -- I sound here almost cynical, which I am not, but if you -- the US labor market is fully employed.

We have an unemployment rate of 4.5%, so if you now be tight on immigration that is going to create a very interesting environment with increased infrastructure spending of where these workforces will come from. So that will be a tight labor market. I think that bodes well for human capital management systems because we help our clients to make more out of their workforces.

Corporate tax reform, we have an effective tax rate around 33%. And if corporate taxes really get lowered to 15% or 20%, ADP would disproportionately benefit from that. So that would be a plus. And you see already today that the market, long-term market rates have peaked and obviously you are aware of our client fund portfolio. We have more than $22 billion of client funds in our portfolio and higher interest rates will boost our interest income that we earn from that going forward.

So if you see the whole range from the Affordable Care Act, some risk to it, undoubtedly and uncertainty to other -- to very clear opportunities that you can calculate today already, it is overall a broad range of impact to ADP.

James Faucette - *Morgan Stanley - Analyst*

So I think that is probably a good place to open it up to see if there are any follow-up questions from the audience or new topics that people want to address.

So while people are thinking about that I want to touch on some of the products and new products that you have been introducing. We -- and Morgan Stanley being obviously a heavy tech research area, one of the things that we found very interesting was your launch of the new app store, the Marketplace, and products that are within that like Data Cloud which gives companies insight into how they are managing their people and running HR.

How has feedback been for Marketplace and the products you have added? And how big of an uplift do you think this could be over the long-term? Is this something that is kind of a nice to have, if you will, or does this have a fundamentally change -- or does it fundamentally change the business and process in the future?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

So both products, the ADP Marketplace and the product ADP Data Cloud, are good examples of our innovativeness. So we won coolest HR product I think last two years in a row for both of -- each of these products. The Marketplace itself creates an ecosystem of apps basically that easily integrate with our own product and solution environment. And it is a reflection of our -- we talked about co-op-petition.

We believe that creating a large environment with ADP's large presence in the marketplace will allow to create really a network of value add to our clients that will I think position ADP at the heart of it, but allow to generate a lot of extra value for our clients by having easy integration to a whole slew of I think we have in the hundreds of apps now in this app store and it is clearly the largest for the HCM space.

And ADP is leveraging our scale and our market presence and our ability to attract a lot of players into this marketplace to it. Early stages, but I view it more as a strategic signal that ADP is prepared to play flexibly in a fast-changing technology driven market space which we are very proud about the early stage of where we are.

Even the more important I think is our strength in data analytics and big data. We have a large client base and we have very good HR data. Payroll data, time and attendance data, benefit data, those transactional systems offer a wealth of insight and we just launched our first product which is called ADP Data Cloud which just basically allows clients to access that database with dozens of benchmarks and predictive analytics products that really I think will transform of how we see value in the human capital management space.

It is going to be a unique advantage to ADP because it is very hard I think for smaller competitors to assemble this kind of wealth of data, 650,000 clients, decades of history, to create that type of insight of the thing I give you an example that makes it intuitive. We have a model now, a predictive model that can predict for each of you your flight risk from your Company and the reasons why you would be more likely or less likely to leave the Company. It is a sophisticated regression model.

And think of the discussion you have as a manager with your employee when you know, well, this employee is paid below average to market, the commute is maybe longer than it should be and it has not had a typical promote. Whatever the reasons are that we are statistically identify make this individual a higher flight risk. I think it transforms the way we are going to work with our employees with how we manage our workforce.

It will transform the way of how HR is going to be talking about what they need relative to budgets and so forth because they benchmark themselves against the appropriate set of competitors to a degree that is much more granular and much more actionable than it has been historically based on survey data.

So this big data thing is not going to only generate a direct revenue stream we sell Data Cloud, small revenue stream now and but it will be incremental to us. But I think it will differentiate us competitively and I think that is a very exciting moment. And we are just think the beginning of the impact of big data onto our solutions that we are very committed and making big investments and seeing already early stages of returns.

James Faucette - *Morgan Stanley - Analyst*

So I want to finish up just with a quick question around M&A. You guys have historically been somewhat active in M&A either because of acquiring products or trying to gain exposure to geography or specific client groups. Can you talk about where you see the most and best opportunity today for future M&A? And how important do you think M&A will generally be returning -- or going forward and try to help us think about how you balance that with cash returns to shareholders?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes, so, I have a minute and 30 seconds to get through this. So we have done few acquisitions in the last few years because we have focused on organic revenue growth. We made technology investments, I talked about those, and we have been focusing on reducing the complexity of our own operations by moving our clients onto these strategic platforms, the cloud based platforms.

So we have been focusing on driving organic revenue with reduced complexity. So acquisitions have played a little bit of a lesser role. We also have a very full product portfolio, we are kind of complete. So areas where we would look at would be these new capabilities. If you think analytics would probably offer a broad range of ideas that we could do. We have new technologies social and so forth, new capabilities. Next-generation stuff I think we would be still looking for M&A.

Our business is shareholder friendly, so we invest of course our priorities of our free cash flow use is to invest into our own operations, I gave you examples in the last half hour. Some acquisitions and then we target our dividend payout ratio of 55% to 60% and have achieved 42 years of dividend increases.

So part of the value proposition that ADP offers to investors is this low capital intensity good margin business that has solid growth and the combination of that with dividend increases going forward well I think is the value proposition that we aim to deliver and that we have in the last few years.

James Faucette - *Morgan Stanley - Analyst*

Well, Jan, that is all the time we have. We really appreciate you and coming in and talking to us about ADP today. Thank you very much.

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Thank you very much, James. Thank you.
